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UNCLAS SECTION 01 OF 02 VIENNA 000675

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SUBJECT: AUSTRIAN AIRLINES CONSIDERING OPTIONS AFTER SAUDI INVESTOR  
PULLS OUT OF INVESTMENT

REF: VIENNA 0395

Summary

1. Saudi investor Sheik Mohamed Bin Issa Al Jaber has backed out of plans to acquire a 20% share in Austrian Airlines (AUA) through an investment of Euro 150 million (\$225 million). Al Jaber claimed that AUA management had misled him about the financial stability of the airline, pointing to the recent announcement of an unexpected first quarter loss of Euro 42.2 million. AUA management appears ready to consider a closer partnership with a strategic partner, possibly Lufthansa. However, senior GoA officials continue to maintain that AUA should pursue a stand-alone strategy to guarantee Vienna Airport's viability and to maintain AUA's extensive network in Central and Eastern Europe and Southeastern Europe. Despite the GoA's position, most analysts predict that AUA will soon need a strategic partner. End Summary.

Saudi Investor Backs Out of AUA Investment

2. Following the release of unexpectedly bad first quarter results for Austrian Airlines (AUA), Saudi investor Sheik Mohamed Bin Issa Al Jaber cancelled his plans to obtain a 20% share in AUA. The investment would have been a Euro 150 million (\$225 million) equity increase (reftel). Al Jaber claimed that AUA withheld financial information from him, including the foreknowledge that AUA would suffer a first quarter loss. Intense negotiations with Vice-Chancellor and Finance Minister Wilhelm Molterer and Peter Michaelis, Head of OIAG, the Austrian Government's holding company, collapsed on May 13. Al Jaber made a series of demands that, in the end, the GoA and OIAG would not accept. Most prominently, Al Jaber requested an additional 10% share in AUA, the replacement of AUA CEO Alfred Oetsch, and additional seats on the AUA board.

AUA's Financial Situation Strained

3. For the first quarter of 2008, AUA suffered an operating loss of Euro 42.2 million and a net loss of Euro 60.4 million, considerably worse than its first quarter 2007 performance (operating loss of Euro 20.6 million and a net loss of Euro 16.3 million). The first quarter performance was somewhat unexpected, following AUA's moderately positive performance in 2007 - an operating profit of Euro 39.1 million and a net profit of Euro 3.3 million.

4. AUA reportedly had planned to use the fresh capital to finance

new aircraft, and to expand its routes into the Middle East and Saudi Arabia. However, some industry analysts, in the wake of Al Jaber's pull-out, speculated that AUA actually needed the new investment for day-to-day operations. Analysts noted that AUA already had exhausted most of the Euro 370 million it received from a capital increase at the end of 2006.

#### AUA Considering Strategic Partnership

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¶5. The turmoil surrounding Al Jaber's investment has apparently sparked a re-thinking within AUA management about the need for a strategic partner. AUA's long-standing strategy, supported by the GoA and OIAG, has been to preserve AUA as a stand-alone carrier without a strategic partner (beyond its Star Alliance arrangement). However, recent comments from AUA management indicate a more open position to forming a strategic partnership. The GoA, on the other hand, has voiced concerns about abandoning AUA's independent status.

In a May 13 interview, Vice-Chancellor Molterer insisted that AUA would remain an Austrian airline. Previously, Chancellor Alfred Gusenbauer and Transportation Minister Werner Faymann had made similar comments.

#### Comment

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¶6. Many industry analysts have long maintained that AUA's stand-alone policy would not be successful in the long run, particularly given its weak financial situation. Lufthansa is

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tapped as the most logical strategic partner for AUA. Lufthansa has refused to comment on AUA's current problems, but it is an open secret that the German carrier has a keen interest in AUA. There have been other, less credible, suggestions of a partnership with Emirates Airlines, Air France's Sky Team, and even with Aeroflot. However, any partnership with an airline outside of the Star Alliance would entail significant costs for AUA. The GoA's opposition to a strategic partner for AUA appears to reflect concerns about the future viability of Vienna Airport (VIE), as well as the desire to protect AUA's extensive network in Central and Eastern Europe and Southeastern Europe (CEE/SEE).

KILNER